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Perestroika: An Insider's View

by

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Foreword

In the Soviet Union, the accession of Mikhail Gorbachev to the position of General Secretary of the Communist Party brought with it an excitement and anticipation of interesting times. Glasnost *and* perestroika, *whether or not they are successful, will have both real and symbolic effects that will persist for a long time. Those of us on the outside looking in watch with cautious optimism. Those on the inside are engrossed in a debate about what exactly should be done and how to do it.*

This special issue of Trade Monitor *— based in part on a luncheon address by Dr. Vladimir V. Popov to a C.D. Howe Institute Policy Roundtable on May 15, 1989 — gives Canadians an opportunity to learn about* perestroika *from an insider's point of view. In this overview of Soviet economic reforms, Dr. Popov writes candidly about the concept of reform, the areas of concern, and the prospects for restructuring the Soviet Union's foreign economic ties.*

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To address the economic reforms now unfolding in the Soviet Union is an enormous task that cannot be entirely covered in a short paper. For those who live in the Soviet Union and who not only observe but also participate in the process of *perestroika* (restructuring), the economic reforms are bigger than life, in the literal sense of the word. Thus, it is more fruitful to concentrate on concerns that are at the heart of the reform process. This paper addresses three specific issues: 1) the conceptual framework of economic reform; 2) the areas of most urgent economic concern; and 3) recent changes in Soviet foreign economic policy and prospects for the restructuring of foreign economic ties.

The Concept of Economic Reform

The agenda for the economic reforms was first set out in the beginning of 1986 at the 27th Party Congress. The Soviet Union is now in the fourth year of economic restructuring, but it is apparent that, to date, the reforms have not yielded the expected results.

In contrast to areas — such as foreign policy, the policy of *glasnost* (openness), or, to some extent, the transformation of the political system — where the recent reforms have been successful, the economic situation shows no visible signs of improvement. There has been no acceleration of economic growth, no significant increase in the supply of consumer goods, and no apparent improvement in the standard of living. On the contrary, shortages persist, lines are becoming longer, and the quality of goods is not improving.

In addressing the question of why the economic reforms, in general, have not been entirely successful, it might be useful to distinguish between the miscalculations in conceptualizing economic reform and the difficulties of practical implementation of the designed changes.

As far as the concept is concerned, it may be argued that the Communist Party leadership and the government have yet to decide the future structure of the Soviet economic system. Moreover, there is no definite consensus among Soviet economists or within Soviet society as a whole as to what that system should look like.

Three Types of Economic Systems

In theory, it is possible to imagine three different types of economic systems at the microeconomic level: directive planning, indicative planning, and market self-regulation.

Directive planning is an economic system in which the government strictly controls the work collectives (or business enterprises). They are told directly what to produce, where to deliver their output, and what types and quantities of factor inputs they may use. The enterprise (or company) in this type of system is a sort of black box, where the volumes of inputs and outputs are planned. In other words, the supply of all the resources is rationed, and company managers are expected to meet production quotas set by the government.

Indicative planning, in contrast to directive planning, is a system in which the government sets prices, but not the amounts of physical outputs or factor inputs. That is, producers are free to choose what to produce and with what kind of inputs in order to maximize their net income. The government does not influence producers directly — by establishing output quotas or by rationing supply — but indirectly through setting prices.

Market self-regulation is the type of economic system that economists have studied the most, and that is best understood. It is based largely on the various mechanisms of automatic and semi-automatic self-adjustment. Evidently, markets with perfect competition and without government intervention do not exist anywhere in the world. Markets are nearly always regulated, to a larger or smaller degree, by government bodies. In market-oriented economies, however, regulations — for example, taxation, subsidization, and monetary policies — mainly provide corrections to the functioning of market mechanisms, and help to modify the operation of these mechanisms. Most importantly, they do not suppress these mechanisms completely, nor do they prevent them from functioning, as occurs with directive or indicative planning.

The Soviet economy of the early 1920s — after the New Economic Policy was proclaimed in 1921 — was largely a market socialist economy. In the second half of the 1920s, however, there was an apparent shift to indicative planning as the use of price controls expanded. Since the late 1920s, directive planning has been the cornerstone of the Soviet Union's economic system. China, Hungary, and Poland provide examples of socialist economies that employ essentially indicative

planning systems. Among the other socialist countries, market self-regulation is most widely adhered to in Yugoslavia, where self-managed work collectives make independent output decisions and where prices are by and large determined by the market. (Market self-regulation is clearly the basis of economic systems in Western countries, but here we are concerned only with socialist markets. The principal difference between capitalist and socialist markets is in the type of ownership — that is, the way in which economic decisions are made. While in capitalist markets it is the major shareholders who finally determine corporate strategy and control the distribution of profits, the major players in socialist markets are, or would be, self-managed production collectives, which make decisions using the one man/one vote principle.)

An understanding of how these three regulatory systems compare is important, since each has different consequences as far as economic efficiency is concerned. Directive planning is overwhelmingly the most inefficient economic system in use anywhere. In theory, it is possible to calculate the social planners' optimal economic plan (the production quotas for all enterprises in volume terms), using the input/output model technique and methods of optimal planning. In practice, however, the number of variables and the enormous quantity of information needed prevent planners from making such calculations at a reasonable cost. Indeed, theory allows one to turn over the entire globe if one has the correct lever and fulcrum. Unfortunately (or fortunately), no such point of leverage exists.

The Inefficiencies of Soviet Directive Planning

The practical outcome of persistent attempts to plan everything — which is much more than physically possible — is chronic large- and small-scale distortions in the Soviet economy. These distortions manifest themselves in shortages of some goods, the overproduction of others, and uneven economic development throughout the economy.

The damage caused by administrative (directive) planning is probably larger in agriculture than in any other industry. In addition to the constraints imposed by the general system of setting production quotas for farms and rationing their supply, the problems here are exacerbated by the huge size of collective and state farms (500 workers and 25,000 acres of land being the average size). Through directive planning, it is simply impossible to manage such giant farms efficiently. To further complicate matters, production by directive planning within the farms themselves probably causes even greater distortions than does the planning environment outside the farms.

The results of such "super-centralization" in agriculture have been disastrous. Agricultural labor productivity is just 20 percent of U.S. levels according to official Soviet estimates, and as low as 10 to 15 percent according to unofficial estimates. The USSR has more arable land per capita than do most countries in the world, but it still imports up to one-fifth of its food requirements.

It is clear that the dismantling of the rigid planning system will result in a considerable increase in agricultural output as well as in productivity. This was the case in China, where similar types of reforms were implemented ten years ago. The Soviet Union has all the necessary factors of production — land, labor, and capital — to increase agricultural output considerably, but so far it has failed to carry the reforms through.

Another striking example of the inefficiencies created by the system of rationed supply is the stockpiling of excess inventories by producers. The value of inventories in the Soviet economy is almost as large as the national income, while in the U.S. economy the comparable indicator is approximately 30 percent of national income. The inventory-to-sales ratio in Soviet industry is 2.4, and in the wholesale and retail trade it is 3.6. In the United States, the same ratios, even in the midst of a deep recession, do not exceed 1.9 and 1.7, respectively. In the first half of the 1980s, the Soviet Union spent an average of 6 percent of its annual national income to build up its inventories, while the United States spent less than 1 percent.

The final example of directive planning inefficiency is the extremely high ratio of capital to output. This ratio is high because of the low capacity utilization rate of Soviet industry caused by an underdeveloped business infrastructure, and by enormous distortions in the production of investment goods and in the utilization of the existing fixed capital stock. In the first half of the

1980s, the Soviet Union, while enjoying the same rate of real economic growth as the United States, had to commit as much as one-quarter to one-third of its national income to net investment — that is, gross investment less depreciation. In contrast, the share of national income devoted to net investment in the United States was less than 7 percent.

On the whole, the differences in the distribution of Soviet and U.S. national income are quite meaningful measures of the inefficiencies of full-scale directive planning. Even if one does not take into account the relative size of the two countries' defense expenditures — which is clearly a special and separate issue — the differences are striking.

Possibilities for Improvement

Yet there is another way to look at these figures. The large proportion of investment in Soviet national income should be considered not only as an indicator of inefficiency, but also as a reserve that might be used to increase consumption and accelerate economic growth. If the Soviet Union manages to make the transition to a market economy, one hopes that it will be possible to reduce the investment share of national income to a normal level. Combined with cuts in military expenditures, which are already being carried out, this could enable consumption to increase by nearly 50 percent without any additional increases in national income. In other words, this implies a reallocation of the available resources — the existing capital stock, the stock of human capital, and current technology — from investment and defense expenditures to consumption. Better organization and management of these resources could also lead to increases in consumption without any additional inputs.

Admittedly, this sounds too good to be true, and one must express certain reservations. First, to obtain such results, the economic reform will have to be radical — there should be a move to a full-fledged market economy, not just to a system of indicative planning. For the moment, at least, this does not seem to be the Soviet government's objective. The predominant concept of economic reform that lies behind government policy, as outlined in the published documents, looks much more like the intention to implement indicative planning than to proceed with the transition to a self-regulated socialist market.

Over 90 percent of Soviet goods are currently traded at prices that are directly controlled by the State Pricing Committee or the industrial departments. So far, the government has not taken any serious steps toward the deregulation of prices. Yet this deregulation is crucial if one expects to increase economic efficiency. Price setting for the entire economy is almost as damaging as is planning physical volumes and the structure of output; it is practically as difficult for the government to set reasonable prices as it is to calculate balanced production quotas in physical terms.

Second, even if the market concept of reform were to be adopted and implemented, it would take at least five to seven years to obtain considerable improvements in economic efficiency. At the same time, it would be necessary to meet the costs of the transition period. It may well turn out, however, that the current economic situation does not leave time for such a delay.

The Current Economic Situation: Areas of Urgent Concern

Bureaucratic Resistance

Three years of *perestroika* have proven that one of the major obstacles for the implementation of economic reforms is bureaucratic resistance. There are numerous cases, widely discussed in the Soviet media, where excellent laws and regulations approved at the very top — by the Central Committee of the Party, the Council of Ministers, and the Supreme Soviet — simply have not been implemented, or have been implemented improperly and thus do not work. The resistance of bureaucratic bodies is quite understandable, since, in political terms, the economic reforms mean the redistribution of power from industrial departments and regional authorities to work collectives and individuals. To achieve success, it is crucial to overcome this resistance to change.

The Need for Business Regulations

There is another major area of concern that has been largely overshadowed by the intense public debate on bureaucratic sabotage in recent years, but that is by no means less important:

there is still no coherent strategy of market regulation, no appropriate institutions, and no qualified personnel to develop and apply such regulations.

To begin with, there is *no competition policy or antitrust legislation*, and the instruments of fiscal and monetary policy are, so far, just in their embryonic stage of development. Meanwhile, the need for legislation and policy instruments of this kind is urgent. If real markets and competition are to appear in the Soviet economy, most of them clearly will be highly monopolized and likely will not function efficiently without the appropriate regulatory mechanisms. As economic theory and evidence suggest, producers with market power tend to limit the level of output in order to increase prices. When demand shrinks, they tend to reduce the volume of production, but not prices. (Thus, prices in these types of markets become rigid and inflexible downward.) In the absence of proper government regulation, this trend may persist, leading to a fall in output and income.

This was the case in all Western countries during the Great Depression of the 1930s, when highly monopolized industries reacted to a shrinking money demand not by reducing prices but by cutting output, thus exacerbating the fall in incomes. This was also the case in the Soviet economy in 1923 during the "scissors crisis", when the so-called trusts and syndicates — socialist monopolies newly created at the beginning of the 1920s — began to inflate prices while simultaneously cutting production. Prices for industrial goods went up dramatically, while prices for agricultural output basically remained stable — since farmers did not exercise any market power. Herein developed the "scissors" effect between industrial and agricultural prices and the underproduction of industrial goods. This might well occur again if the Soviet Union proceeds with the transition to market self-regulation without the necessary mechanisms to offset the negative outcomes of an oligopolistic and monopolistic market structure.

It is planned that the share of total output ordered by the government — that is, the share of output subject to directive planning, or mandatory production quotas — should decline in the main industrial sectors from over 90 percent in 1988 to 25–50 percent in 1989. In other words, less than half of the total volume of industrial output will be planned, with the work collectives being able to decide on their own how to use the remainder of their productive capacity. A poll conducted in late 1988 among managers of industrial enterprises revealed that 20 percent intend to reduce their output by 15–20 percent and to raise prices by even more, so that output measured in current prices will increase nevertheless. This is despite the present rigid control over prices exercised by the State Pricing Committee and industrial departments.

To avoid this painful development and to prevent another "scissors crisis" in the Soviet economy, it is necessary to design an effective government competition policy. This should include antitrust legislation, the dismantling of absolute monopolies, and the liberalization of imports, among other things. It is also necessary to develop a strategy and a mechanism for the implementation of macroeconomic policies (both fiscal and monetary). At the present time, the Soviet Union does not have any experience in these areas, and there are simply not enough specialists to develop and implement such policies. It will also be necessary to develop the financial markets themselves and to restructure the banking system to facilitate the use of monetary policy.

The Need to Restructure Social Policy

The same is true for the whole area of social policy. Here again, the Soviet Union is currently unprepared to deal with the problems that inevitably will be created by the move to a market economy. The transition will entail a substantial reallocation of resources. For example, many enterprises will be created and many will shut down, and millions of workers will have to change jobs. The distribution of income will become more uneven. Inflation and changes in relative prices may seriously affect the well-being of everyone, especially those on fixed incomes.

The present social security network can be regarded as obsolete, and it is unlikely to be able to withstand the pressures that would arise from the move to a market system. Unless there is a radical shift in the social welfare system — employee retraining, the old age pension system, unemployment insurance, indexation of income, and the like — the transition to a market system may be accompanied by unacceptable damage to certain segments of Soviet society.

The Need for Monetary Controls

Finally, one cannot expect the market system to be efficient in the presence of the distortion in national monetary circulation that has occurred in recent years due to the accelerated growth of the money supply. The government budget deficit increased from an average of 20 billion rubles in the first half of the 1980s to 120 billion rubles in 1989, and is currently about 14 percent of GNP. In Canada the same indicator is less than 5 percent of GNP, and in the United States it is less than 3 percent. The whole problem is aggravated by the fact that, in the Soviet Union, the deficit is financed not by government borrowing in financial markets, but mainly by printing money. Consequently, the gap between the demand for money and the supply of goods is constantly increasing.

In a system with fixed prices set by planning bodies, this gap largely manifests itself in increased shortages — that is to say, the increase in the gap between the money demand for goods and the supply of those goods that is not matched by growing prices. Thus, it makes sense to speak about the rate of devaluation of the ruble (or loss in purchasing power) — resulting not only from inflation, but also from increased shortages.

The official consumer price index increases at a slow rate in the Soviet Union, registering a 1 percent annual increase in retail prices. But this is questionable, as unofficial estimates range between 3 and 5 percent annually. Also, shortages of goods are increasing even more quickly, so that the ruble may be losing purchasing power at a rate of 10–15 percent annually. This rate of currency devaluation is probably at a critical level. After this level is exceeded, there develops a cumulative process of devaluation as people try to rid themselves of unstable paper money, which increases the velocity of circulation and feeds inflation. This cumulative process distorts the entire monetary circulation and makes it impossible for the government to use regulatory instruments effectively. It can, in fact, lose control over the economic situation as its room to maneuver narrows.

The ability of the Soviet authorities to achieve economic policy targets, therefore, tends to be paralyzed. It also leads one to believe that, in this highly inflationary environment, it will be difficult to benefit from the potential advantages of the market mechanism. In short, the whole notion of a market economy might be discredited if the Soviet Union does not prepare itself for the transition and create the necessary regulatory mechanisms and institutions. The Soviet Union may find itself in the same position as a man bravely crossing the ocean in a boat without a sail and a rudder.

Foreign Economic Policy

The Changes Under Way

A reform of foreign economic ties is an inalienable component of the economic restructuring now under way. These changes must seek to liberalize Soviet trade and to gain access for Soviet exporters to foreign markets, as well as to entice foreign firms into investing in the Soviet Union. In future, the Soviet Union must become an active participant in global economic processes and a full-fledged member of the world economic community if it is to take full advantage of the benefits of the international division of labor and the internationalization of economic life.

Since 1987, 22 ministries and industrial departments, as well as 77 associations, enterprises, and other organizations, have received the right to carry out import-export operations directly in the foreign market. That year, they accounted for 20 percent of all the Soviet Union's foreign trade, including two-thirds of the exports of machinery and equipment. The number of such departments and enterprises is increasing: by the autumn of 1988, the majority of all the industrial departments, all Union republics, and more than 100 enterprises, interbranch scientific-technical complexes, and other organizations had received the right of direct access to the foreign market. In 1987, their share of total exports was 12 percent, and of total imports 28 percent; corresponding figures for 1988 were 25 percent and 44 percent, respectively. It is planned that in 1989 the enterprises' foreign-exchange funds will be increased to 2 billion rubles.

The administration of foreign economic ties has also been restructured. A State Foreign Economic Commission and a Ministry of Foreign Economic Ties have been created. The management of external economic contacts, which was formerly dispersed, has now been concentrated in these bodies.

At the beginning of 1987, the creation of joint enterprises and associations with the participation of foreign firms was authorized by edict of the Presidium of the Supreme Soviet and by decrees of the Council of Ministers. The capital of these companies is formed from contributions made by Soviet and foreign firms. In the case of joint companies with partners from capitalist and developing countries, the Soviet share must be no less than 51 percent. No plan is set for these companies. They are supplied on a priority basis, and their profits are distributed among the participants in accordance with their shares. After the first two years, joint companies begin to pay taxes — 30 percent of the profits remaining after investments and deductions for reserve funds, plus another 20 percent when the profit due to the foreign partner is transferred abroad.

The establishment of a "preferential economic regime" in a number of regions in Siberia and the Far East is being discussed, to give producers tax privileges and the right of direct access to foreign markets and independent use of hard currency earnings, to abolish the tariff wage system — a schedule of wage rates set by the State Committee on labor and social policies — and the like. Plans call for creating special "joint business enterprise zones" in the Far East, which would have a privileged system of customs duties, licensing of import and export arrangements, and taxation.

By the middle of 1988, three member countries of the Council for Mutual Economic Assistance — the Soviet Union, Czechoslovakia, and Bulgaria — had reached agreement on using their national currencies in joint accounting. So far, however, this right is enjoyed only by participants in agreements on direct ties, joint enterprises, and international associations.

Soviet Integration into the World Economy

Rapprochement with some international economic organizations has also begun. In 1986, the USSR stated its desire to obtain observer status in the General Agreement on Tariffs and Trade, with a view eventually to gaining full membership. In the summer of 1987, it became a member of the General Fund for Raw Material Commodities, which was formed within the framework of the United Nations Conference on Trade and Development and which is, in effect, an international bank for financing programs to stabilize prices of raw materials and for projects to expand the production and consumption of raw materials. More than 100 countries, including most of those in the West, participate in the Fund (the United States, which signed the agreement in 1980, subsequently refused to ratify it).

In December 1988, the Council of Ministers took an important step by announcing that, beginning on April 1, 1989, all enterprises and coops that can compete on the world market would have the right to conduct, on their own and on the basis of foreign-exchange self-accountability, all import-export operations. Furthermore, several unreasonable limitations on the activities of joint ventures — most importantly, the requirement that no less than 51 percent of the equity of any joint venture be held by Soviet participants — were abolished. Other measures include plans for the organization of foreign-exchange auctions, where enterprises will be able to trade foreign currency for rubles between themselves, and the establishment of a new official exchange rate for the ruble beginning on January 1, 1991.

The implementation of these measures will actually mean the adoption of market principles in the distribution of part of the hard currency — specifically, that part which is now channeled into the enterprises' foreign-exchange funds, or 30–50 percent of total foreign-exchange earnings. If, in addition, the government commits itself to trading the remaining part of the foreign currency — the part which is now being taken away from the enterprises — using the new reasonable exchange rate, there would be a sort of *de facto* real convertibility on current account. This would change, in principle, the current foundations of the mechanism of import-export operations. That is to say, the major part of the foreign currency would be distributed not by bureaucratic bodies, which is the case now, but by the market. The owners of foreign currency, including the government, would then sell it to those who wish to buy at a market-determined rate.

Reform of foreign economic ties has already yielded certain results. Foreign trade firms set up by enterprises and industrial departments not attached to the Ministry of Foreign Trade (now the Ministry for Foreign Economic Ties) have begun to operate. Many producers are now exporting goods themselves through these firms and are independently buying equipment abroad with the hard currency earnings accruing to them. Joint

companies have also started operations and are producing. By mid-April 1989, their number had increased to 384.

Unfortunately, the new foreign economic policy has not been entirely successful. The Soviet Union's foreign trade turnover (exports and imports) in terms of value fell from 142 billion rubles in 1985 to 129 billion rubles in 1987 and increased to just 132 billion rubles in 1988. Increases in the volume of foreign trade have also been quite modest in recent years — 2 percent in 1986, 1 percent in 1987, and 2.5 percent in 1988. The structure of Soviet foreign trade remains obsolete, archaic, and essentially "colonial" in nature, consisting mainly of barter exchange of Soviet natural resources for foreign machinery, equipment, and consumer goods. Joint ventures still operate only on a limited scale, and Soviet participation in international financial markets is negligible.

Part of the reason for such poor performance was the slump in 1986 in the world prices for oil and gas — the staples of Soviet exports. The other part lies in the difficulties of the transition period. As the old mechanisms of foreign economic ties are gradually being phased out, the new mechanisms are just being formed and are not yet working at full strength. As well, enterprises that first obtained the right to proceed with import-export operations on their own often lacked the necessary experience, and mismanaged deals with foreign partners or completely disrupted existing trade relations. Bureaucratic delays and traditional red tape have created additional obstacles.

The Task Ahead

It should be recognized that there are some areas where the reforms simply do not go far enough to provide the expected results.

Ruble Convertibility

First, both the growth of foreign trade and the creation of joint companies are now being held back by the inconvertibility of the ruble. Without such convertibility, it is unrealistic to expect that Soviet industry will emerge as a world leader. The new economic mechanism now replacing the former directive planning system can ensure, at best, greater scientific and technical progress within the USSR, but not the achievement of world efficiency and quality standards. In order to attain and surpass these standards, the USSR must throw bridges across the abyss dividing the Soviet and world economies. Most important of all, the USSR must establish a realistic and single currency-exchange rate by which producers may exchange rubles for foreign currency without limitation.

It is often asserted that ruble convertibility is a matter for the distant future and that it is only possible after carrying out price reform — and then only after smoothing out the obvious disparities between domestic and world prices. However, this is obviously just a pretext. Clearly, differences in the structure of domestic and world prices will not disappear in the foreseeable future. The Soviet Union cannot blindly copy world market prices either today or in the near future. For example, suppose the world price ratio between grain and computers is roughly ten tonnes of grain for a simple personal computer. Since production costs in the Soviet domestic market are equivalent to at least 100 tonnes of grain — that is, ten times the world rate — no one in the Soviet Union would then produce computers.

There is, however, a simple method of smoothing out differences in prices on the domestic and world markets, a method mankind has used for several centuries: customs duties, which the Soviet Union generally did not need with its super-centralization of imports, and which, therefore, have ceased to play any kind of role in Soviet trade policy. With a system of customs duties, it would be possible, within broad limits, to regulate the volume and pattern of imports when the ruble is convertible. And this would simply be regulation of a market mechanism, not its complete replacement by directive planning of all imports. The simple control of imports by means of changes in customs tariffs has obvious advantages over directive planning. In short, with a sensible system of customs duties, the Soviet Union can, without shelving the matter, at least begin a gradual transition to the convertibility of the ruble for enterprises (though not for individuals), while simultaneously granting direct producers broad rights to make purchases on the world market.

Incentives for Foreign Investment

Second, as long as the Soviet Union has decided to draw foreign firms into its national

economy, this policy must be followed unambiguously and consistently. Until now, the matter has gone far too slowly. By the beginning of 1988, one year after the adoption of relevant government decrees and half a year after the first joint company — the Soviet-Hungarian "Littara-Volnapak" Association in Lithuania for the production of packing materials — began operations, about 30 joint companies, including 17 with Western countries, were in existence; by the middle of 1988, a total of 61 joint enterprises with assets amounting to several hundred million rubles had been created; by the beginning of 1989, about 200; and by May 1989, about 400.

But the USSR needs much more. It now lags tens and hundreds of times behind in terms of the value of foreign direct investment in its economy, even when compared with other socialist countries, not to speak of the Soviet Union's own potential possibilities. Since 1979, when China began to follow an "open door" policy, an average of 1,000 enterprises have been created annually with the participation of foreign capital. Today, their total number is nearing 10,000, with a total capital investment exceeding U.S.$8 billion.

In general, foreign capital does not come by itself. It must be attracted, and if steps already taken do not bring results, new and additional stimuli must be introduced. The mountain is clearly not preparing to go to Mohammed, which means that he himself must go to the mountain.

Access to International Financial Markets

Third, the Soviet Union must fundamentally re-examine its policy toward international financial markets. In January 1988, a branch of the Soviet Foreign Economic Bank in Zurich issued the first bond loan in convertible currency. In the past, financial reserves were attracted solely in the form of bank credits. Free hard-currency resources were only temporarily invested in bonds in order to gain profits. This time, bonds with a 5 percent return and a maturity of ten years with a total value of 100 million Swiss francs have been sold to anyone who wanted to buy them, whether banks, corporations, or individuals.

The loan's success, in the opinion of Foreign Economic Bank specialists, exceeded all expectations — all bonds were sold in four days. This direct entry into the international bond market is unquestionably a desirable change, an event which, in the words of a Swiss banker, will go down in world banking history. But the Soviet Union absolutely must move further, to a position where access to international capital markets ceases to be the monopoly of the Foreign Economic Bank, and all banks and enterprises receive the right to carry on international financial-credit and hard-currency operations.

The USSR apparently should not worry too much about whether the access of enterprises to international credit markets will lead to an increase in its foreign indebtedness. The net Soviet debt in convertible currency — less than U.S.$30 billion — is considered to be a modest amount by international standards. The United States, for example, has a net international indebtedness approaching $500 billion and, according to predictions, it may rise to $1 trillion in the early 1990s. Brazil has more than $100 billion in net debt, and Mexico only a little less. In general, the Soviet Union's position, considering all types and all geographical dimensions of indebtedness, is still that of a creditor, not a debtor. If the ruble becomes convertible, payments from Soviet creditors issued in rubles can, in principle, be transformed into convertible currency and used to repay loans made by the West.

It is likely that many larger Soviet enterprises that export products to Western countries and

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are well known there — for example, the Paton Institute, the Volzhskiy auto plant which produces Ladas, and others — are already able to obtain loans independently on international financial markets in order to expand export production. Naturally, guarantees would be necessary, but the Foreign Economic Bank could certainly give them — the Soviet Union's credit reputation is not doubted in international financial circles. Moreover, a possible increase in the Soviet Union's borrowings is perceived in the West as a perfectly natural phenomenon during the stage of cardinal restructuring of all spheres of Soviet economic life.

No doubt, monetary borrowings must be used sensibly, and loans from the West must be accompanied by measures that allow for future receipts of hard currency to repay them. Debts may be incurred on world financial markets using such "real collateral" as radical reform in agriculture, which, if carried out, undoubtedly would lead to a sharp rise in the production of foodstuffs and consequently a reduction in their importation from abroad.

The Soviet Union should also consider the possibility of using part of its foreign borrowings, as well as its gold and hard-currency reserves, to pay for imports, and of converting its credits with socialist and developing countries, denominated in rubles, into hard currency or into real and financial assets of Soviet enterprises and organizations abroad (for example, in debt-equity swaps, which are already in existence).

The Need for More Openness

Finally, an essential condition for the effectiveness of Soviet external economic policy is its complete openness. Unfortunately, the situation so far in this respect is worse than anywhere else. The Soviet Union is distinct from all the advanced countries in the West and from the majority of socialist and developing countries in that it still does not publish regular and detailed statistics on the balance of payments, the international investment position and foreign indebtedness, gold and hard-currency reserves, monetary aggregates, or exchange rates. Such secretiveness, which is already the subject of general discussion, undermines confidence in the Soviet Union on the part of international business and financial circles, and during a period of openness such "closedness" is simply an anachronism. If the Soviet Union truly wants to become a full-fledged member of the international economic community, it should begin by making public statistical and other data relating to foreign trade and to financial and credit ties.

These are only a few basic desirable directions for the further restructuring of Soviet foreign economic ties. Movement in these directions would enable the Soviet Union to participate fully in international economic life and to reap real benefits from the economic internationalization now unfolding on all levels.

Conclusion

So far, economic reforms in the largest socialist country — the Soviet Union — have created more problems than they have solved, and the debate inside and outside the country intensifies as to what should be done.

The Transition to a Market Economy

Being generally optimistic about the *perestroika* process, many Soviet economists — the author among them — believe that there is a way to proceed with economic reforms and make a successful transition to an efficient market socialist economy at a low cost without major sacrifices, and without a fall in real incomes.

This way implies that bureaucratic resistance will be overcome and that radical reforms, first of all in agriculture, will be carried out. It implies that the government budget deficit will be considerably reduced and monetary equilibrium in the economy will be restored. It also requires the development of a special strategy of market regulation and the creation of special institutions and policy instruments to implement such a strategy. If this is the case, if there is a move to a socialist-regulated market, economic *perestroika* will begin to pay for itself in the long term — say, in five to seven years. The new market mechanisms of resource allocation will increase economic efficiency and make it possible to reduce current huge losses and to redistribute national income in favor of consumption.

The major problem in this scenario is how to handle properly the transition to a market

economy and to manage the restructuring of the economic system so as to prevent a reduction in living standards, a rise in unemployment, an outburst of inflation, and an unreasonable distribution of income.

Technically, it is possible to meet the costs of a transition period by increased borrowing inside the country and abroad. Fortunately, since the Soviet Union's internal and external indebtedness is now at quite a low level, it seems to make sense to proceed with such borrowing. While this will actually increase the government budget deficit, as compared with printing money, it will pump excess money out of circulation, and thus eliminate the gap between money demand and the supply of goods. If borrowings in hard currency are used for imports of consumer goods, the Soviet Union will manage to saturate the market and to meet the costs of adjustments to the new economic system, which will eventually stimulate a considerable improvement in efficiency. This is one possible, and apparently the most preferable, scenario for economic reform.

An Alternative Scenario

There is, however, another scenario of economic restructuring, one which implies that the reforms will be slow and gradual, not radical; that the government budget deficit will not be reduced substantially and that increases in prices and shortages will persist; and that the government will not be able to apply a coherent set of competition, social, fiscal, and monetary policies.

If these urgent needs are not met, if the government fails to implement the necessary changes, the transition to a new market economic mechanism in a short time and at a low cost will not be possible. The Soviet economy will then enter a painful period of "stop-and-go" policies, with government attempts to stimulate the economy and to accelerate the implementation of reforms likely leading to increased inflation, income inequality, indebtedness, and so on. At the same time, government efforts to reduce inflation by tightening price controls will impede the progress of economic reforms and delay the transition to the new economic mechanisms. This, in fact, is already happening: at the end of 1988, the Council of Ministers, frightened by the acceleration of price increases charged by co-operatives — the newly created independent enterprises in services and industry that operate without a plan — passed a regulation imposing stricter control over co-op prices.

Such stop-and-go policies may now be observed in socialist countries that walked earlier than did the Soviet Union along the road to economic reforms: in Yugoslavia, where inflation is running at a rate of several hundred percent, in Hungary, China, and Poland, where inflation is over 15 percent and international indebtedness tends to surpass acceptable levels. The Soviet Union, however, does not have to repeat these countries' mistakes. Although time is running out quickly, the Soviet Union is still able to control the maelstrom of events that threaten to drive the economy into a costly and dangerous period of "stop-and-go" policies.

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